

**+BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 17334
[Redacted],	)	
	)	DECISION
Petitioners.	)	
_____	)	

On April 28, 2003, the staff of the Tax Discovery Bureau of the Idaho State Tax Commission issued two Notices of Deficiency Determination to [Redacted] (taxpayers), proposing income tax, penalty, and interest for the taxable years 1997 through 2001 in the total amount of \$34,316.

On May 8, 2003, the taxpayers filed a timely appeal and petition for redetermination. The taxpayers did not request a hearing but did provide the Tax Commission with additional information to consider. The Tax Commission, having reviewed the file, hereby issues its decision.

The taxpayers filed a 2001 Idaho individual income tax return reporting to Idaho a substantial amount of taxable income but with zero tax on that income. Included with their return, the taxpayers provided disclosure statements, a declaration of material facts, a declaration of gross income, statements and asseverations of exclusion of remuneration from gross income, and a letter explaining the purpose for filing their return. The return processing section of the Tax Commission saw a problem with the taxpayers' return and referred it to the Tax Discovery Bureau (Bureau). The Bureau reviewed the return and determined it was not completed correctly. The Bureau corrected the taxpayers' return and sent the taxpayers a Notice of Deficiency Determination.

The Bureau also researched the Tax Commission's records and found the taxpayers did not file Idaho income tax returns for 1997 through 2000. The Bureau sent the taxpayers a letter asking them about their requirement to file income tax returns for the years 1997 through 2000. The taxpayers did not respond. The Bureau obtained information [Redacted] and determined the taxpayers were required to file Idaho income tax returns. The Bureau prepared 1997 through 2000 returns for the taxpayers and sent them a Notice of Deficiency Determination.

The taxpayers protested both of the Bureau's determinations. The taxpayers stated they did not live in Idaho in 1997 through 2000. They stated they moved to Idaho sometime in the third quarter of 2001. As for tax year 2001, the taxpayers stated that neither of them incurred any federal income tax liability. They stated that while they reside in Idaho as American citizens, they have never been identified as parties [Redacted] who are required to file [Redacted] Since the Idaho Code section 63-3030 states that every resident individual required to file a federal return under section 6012(a)(1) is required to file an Idaho return, the taxpayers claimed to have no filing requirement with Idaho because they were not required to file a federal return.

The Bureau recognized the taxpayers' statements as those made by individuals in the tax protestor movements. Therefore, the Bureau referred the matter for administrative review. The Tax Commission sent the taxpayers a letter giving them two alternative methods for having the Notices of Deficiency Determination redetermined. The taxpayers responded that they have no reason to "protest" anything. They stated Idaho's income tax laws do not apply to them as illustrated by the statutes the Idaho State Legislature created. Again they stated they were not required to file federal income tax returns and, by virtue of Idaho Code section 63-3030, they do not meet the requirement to file and/or pay an Idaho income tax.

The taxpayers stated further that neither of them have ever elected or chosen to become federal employees. They have not entered into an employment contract within the U.S. government or conducted a trade or business within the United States that would subject them to the requirements of the Internal Revenue Code. They have no federal income tax liability.

The taxpayers continued with an argument that the legislative intent of the Sixteenth Amendment to the U.S. Constitution was that the federal income tax was levied upon the National Government and not upon those Americans living in the current 50 states of the Union. They stated the geographical jurisdiction of the National Government is limited to Washington D.C. and the U.S. territories and possessions. The taxpayers stated those are the only areas where the federal income tax is applicable unless one chooses to volunteer to gift the national government their hard-earned money.

In addition to the arguments presented, the taxpayers provided documentation to establish that they were not residing in Idaho in 1997 through the early part of 2001. The documentation included utility bills, a notice from the Internal Revenue Service, W-2 wage statements, 1099s, a margin interest statement, an accountant's instruction sheet for filing their 1997 federal income tax return and their [Redacted] state return, and a lease contract.

The Tax Commission reviewed the taxpayers' information and found that the documents the taxpayers provided were sufficient evidence to show that the taxpayers were not living in Idaho in 1997 through the first part of 2001. The record was also devoid of any information showing the taxpayers had income from Idaho sources in 1997 through 2000. Since the taxpayers were not residents and had no Idaho source income, the Tax Commission determined the Notice of Deficiency Determination for the tax years 1997 through 2000 should be cancelled.

However, as the taxpayers stated and their documentation shows, the taxpayers did move into Idaho in 2001. Therefore, as part-year residents, the taxpayers were required to report their income from Idaho sources while nonresidents and their income from all sources while residents of Idaho (Idaho Code section 63-3026A). The taxpayers argued they were not required to file an Idaho income tax return because they were not required to file a federal return. They stated they were not parties made liable for the federal income tax and therefore not required to file a federal return under section 6012(a)(1) of the IRC. The taxpayers cited Idaho Code section 63-3030(1) which states that every resident individual required to file a federal return under section 6012(a)(1) of the IRC is required to file an Idaho return. Since they are not required to file a federal return, they are not required to file an Idaho return.

The taxpayers argued that they are not liable for the federal income tax. The Tax Commission disagrees, but also sees the taxpayers missing a critical point. Idaho Code section 63-3030 references IRC section 6012(a)(1) for setting the thresholds for filing an Idaho income tax return. Section 63-3030 states that every individual required to file a federal return under section 6012(a)(1) of the IRC is required to file an Idaho return. IRC section 6012(a)(1) states that every individual having gross income in excess of the exemption amount is required to file a federal return. Therefore, for Idaho purposes, every individual having gross income in excess of the exemption amount is required to file an Idaho return.

Idaho Code section 63-3011 defines gross income as it is defined in IRC section 61(a). IRC section 61(a) states that gross income is all income from whatever source derived. The taxpayers filed a 2001 return showing they received gross income in excess of \$73,000. This amount is well in excess of the threshold amount in IRC section 6012(a)(1). Therefore, the presumption is that the taxpayers were required to file an income tax return with Idaho.

The taxpayers argued their income is not taxable because they did not have income from taxable sources. The taxpayers stated they had no sources of income as referred to in IRC section 61, which defines gross income in general as "all income from whatever source derived." The taxpayers believe the "source derived" is legally limited by definition in IRC section 861 and the regulations there under. The taxpayers believe that only the income described in the "operative sections," as listed in the regulations, are sources within the United States and therefore taxable. Since the taxpayers have no income from the identified sources, they have no taxable sources of income.

The Tax Commission views the source of income argument as a misinterpretation of the IRC. Section 861 of the IRC is for guidance in determining whether income is from sources within the United States or without the United States in the determination of the taxable income of non U.S. citizens, nonresident aliens, and foreign corporations. Regulation 1.861-1(a) states in part, "[T]hese sections explicitly allocate certain important sources of income to the United States or to areas outside the United States, . . ." The regulation goes on to say, "[T]he rules contained in this section apply in determining taxable income of the taxpayer from specific sources and activities under other sections of the Code, referred to in this section as operative sections." The operative sections referred to are for the determination of whether income is sourced within or outside the United States in order to compute other provisions of the IRC, i.e. foreign tax credit, DISC and FSC income, etc.

When faced with individuals arguing that they have no sources of income within the United States, the courts have stated,

Apparently, petitioner believes that the only sources of income for purposes of section 61 are listed in section 861, that income from sources within the United States is taxed only to nonresident aliens and foreign corporations pursuant to sections 871, 881, and 882, and that section 1461 is the only section of the Internal Revenue Code that makes anyone liable for the taxes imposed by sections 1 and 11.

Section 61(a) defines gross income generally as 'all income from whatever source derived,' including, but not limited to, compensation for services and interest. Sec. 61(a)(1), (4). Section 63 defines and explains the computation of "taxable income". Section 1 imposes an income tax on the taxable income of every individual who is a citizen or resident of the United States. Sec. 1.1-1(a)(1), Income Tax Regs.; see *Habersham-Bey v. Commissioner*, 78 T.C. 304, 309 (1982).

Under section 61(a)(1) and (4), petitioner clearly is required to include his wages, tokens, and interest in gross income. It is well established that compensation for services, in whatever form received, is includable in gross income . . . Petitioner is liable for Federal income taxes on the wages, tokens, and interest he received during 1991. *Aiello v. Commissioner*, T.C. Memo. 1995-40.

Plaintiff argues further that his remuneration is exempt from taxation under 26 U.S.C. § 861(a)(3)(C)(ii), and thus excludable under 26 U.S.C. § 61 and, by reference, excludable under Wisconsin law. Suffice it to say that if plaintiff wished to avail himself of § 861(a)(3)(C)(ii), he would have to show that his work was done for a foreign office, or an office in a United States possession, of a domestic business entity. He has not alleged this, and it is clear from the record that he performed his work in the State of Wisconsin for Wisconsin employers. *Peth v. Breitzmann*, 611 F. Supp 50.

In his petition, petitioner contends that respondent erred in determining the deficiencies and additions to tax because 'All income received by Petitioner for the tax years in question is/was untaxable 'earned income' as defined in I.R.C. Section 911(d)(2)(A).' At the hearing on respondent's Motion For Summary Judgment, petitioner also claimed that 'all of my gross income was received without the United States as defined in Subchapter N of 26 CFR 1.861-1', and 'I am not a citizen of the

federal U.S. I make a living in the state of [Redacted] as a right, and I am not subject to the jurisdiction of the federal United States.'

We find no support for petitioner's position in the authorities he cites. Section 911(d)(2)(A) provides a definition of "earned income" for purposes of section 911. Section 911(a) allows an exclusion from gross income for foreign earned income at the election of a qualified individual, defined as an individual whose tax home is in a foreign country. Sec. 911(d)(1). Petitioner had no foreign earned income and is not a qualified individual for purposes of section 911. Similarly, petitioner's position is not bolstered by the regulations under section 861. To the contrary, section 861(a)(1) and (3) provides that interest from the United States and compensation for labor or personal services performed in the United States (with exceptions not applicable here) are items of gross income which shall be treated as income from sources within the United States.

Section 1 imposes an income tax on the income of every individual who is a citizen or resident of the United States. During the years at issue petitioner resided in [Redacted] and therefore was a resident of the United States and subject to tax under section 1. A Federal income tax return must be filed by all individuals receiving gross income in excess of certain minimum amounts. Sec. 6012; sec. 1.6012-1(a), Income Tax Regs. Petitioner's gross income in each year exceeds the minimum amount. In short, petitioner is a taxpayer subject to the Federal income tax laws. Solomon v. Commissioner, T.C. Memo 1993-509.

As a citizen of the United States during the years at issue, petitioner is subject to United States Federal income tax on his worldwide income. Sec. 1; Cook v. Tait, 265 U.S. 47 (1924); sec 1.1- 1(a)(1) and (c), Income Tax Regs. It is unnecessary to determine whether that income was from sources within or without the United States since petitioner is not a nonresident alien. See sec. 861." Dacey v. Commissioner, T.C. Memo 1992-187.

The underlying fact is the taxpayers are U.S. citizens and they resided in the United States in 1997 through 2001. Therefore the taxpayers are subject to tax on their worldwide income. However, for Idaho purposes, the taxpayers were Idaho residents for only part of 2001. Consequently, the taxpayers were required to report to Idaho their income from Idaho sources while they were nonresidents and from all sources after they moved to Idaho.

The return the taxpayers provided for 2001 reported their income as if the taxpayers were full-year residents of Idaho. The correction or adjustment the Bureau made to the taxpayers' 2001 return doubled the taxpayers' income for the year. Neither of these returns is correct. The documentation the taxpayers provided showed the taxpayers moved to Idaho sometime in May 2001. Therefore, the proper return for the taxpayers is a part-year resident return.

The information the taxpayers provided with their return gave a good indication of the income the taxpayers received while they were residents of Idaho. The Tax Commission adjusted the taxpayers' return to show the income received while they were Idaho residents and to reflect their part-year resident status.

The Bureau added interest and penalty to the taxpayers' Idaho tax liability in accordance with Idaho Code sections 63-3045 and 63-3046. The Tax Commission finds the addition of interest appropriate for the 2001 year; however, the Tax Commission did not find any support for the fraud penalty added by the Bureau. The taxpayers' 2001 return was filed delinquent, so the Tax Commission reduced the fraud penalty to a delinquency penalty.

The taxpayers' arguments failed to persuade the Tax Commission that they had no taxable income or that their income was exempt from taxation. However, they did show that only a portion of their income for 2001 was reportable to and taxable by Idaho. They further showed that for the taxable years 1997 through 2000 no Idaho returns were required of them.

WHEREFORE, the Notice of Deficiency Determination for the taxable years 1997 through 2000 dated April 28, 2003, is hereby CANCELLED.

WHEREFORE, the Notice of Deficiency Determination for the taxable year 2001 dated April 28, 2003, is hereby MODIFIED in accordance with the provisions of this decision and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.



IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2001	\$2,860	\$715	\$411	\$ 3,986
			Less amount remitted	<u>(11,239)</u>
			Overpayment	\$ 7,253
			Interest	<u>526</u>
		TOTAL TO BE REFUNDED		<u>\$ 7,779</u>

An explanation of taxpayers' right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2004.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

#### CERTIFICATE OF SERVICE BY MAIL

I hereby certify that I have on this \_\_\_\_ day of \_\_\_\_\_, 2004, served a copy of the within and foregoing DECISION by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.

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